

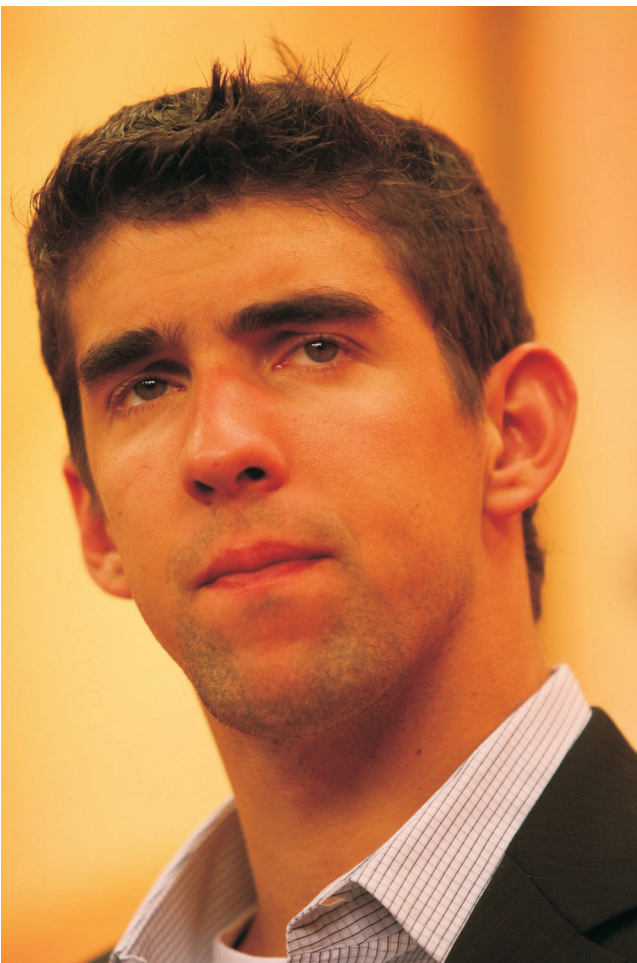
NEWS ANALYSIS

Lobbyist With Limo Withdraws From HHS Nomination

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Michael Phelps was photographed using a bong. Who cares?

Many coastal residents could not begin to care whether the winner of 14 Olympic gold medals smokes marijuana. Substantial numbers of Americans smoke the stuff, which does have health risks,



Newscom

Was Tom Daschle as oblivious about his public image as this guy?

and many people believe it should be decriminalized, as it essentially has been in California over the objections of the federal government.

But there's a group of people who are really having a bad trip about Phelps's toking. Those would be decision-makers at companies and ad agencies with which Phelps has endorsement contracts. They have to decide how bad the damage is to their brands.

As Phelps is undoubtedly finding out, every one of those endorsement contracts has a clause requiring him not to engage in behaviors that would besmirch the brand. An invasion of privacy? Yes, but the price of being paid for one's image is having that image monitored. If Phelps wanted privacy, he should not have signed those contracts.

What's the difference between Michael Phelps and former Senate Majority Leader Tom Daschle, who on February 3 withdrew from his nomination for health and human services secretary? Both engaged in behavior that is inconsistent with the deal they made with the public.

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Phelps acted inconsistently with his highly marketable hero status. Daschle betrayed the public trust by failing to report fairly large amounts of income. Phelps, however, is endangering only his future income stream. While Daschle cost himself some money, to be sure, he also put much more in play. As information dripped out about the holes in Daschle's tax returns, he put the credibility of the entire Obama administration to the test. Daschle's tax returns should be cleaner than Phelps's bloodstream.

President Obama gave Daschle the kiss of death on February 2. The president said he "absolutely" stood behind his nominee, and did not elaborate, after a meeting in the Oval Office to discuss the economy with Vermont Republican Gov. Jim Douglas. The implication of this statement is that the president would not lift a finger to help Daschle's confirmation if the Senate was of a mind to reject him.

That fateful evening, members of the Senate Finance Committee met privately to discuss revelations that Daschle failed to pay more than \$128,000

in taxes from 2005 to 2007. Also on the evening of February 2, the Senate confirmed, by a 75-21 vote, Eric Holder as Obama's attorney general.

Like Phelps, Daschle made a belated, lame, and halfhearted apology, his in the form of a letter to the Senate Finance Committee. Daschle released the letter, in which he said he was "deeply embarrassed" by "errors" on his tax return. "My mistakes were unintentional," he whined. (For the letter, see *Doc 2009-2126* or *2009 TNT 20-32*.)

Daschle wrote that he was "deeply embarrassed and disappointed by the errors" that required him to amend his tax returns. He ascribed his unreported consulting income to a "clerical error" that InterMedia Advisors had made on the Form 1099. He noted that charitable deductions had been challenged by the Obama vetting team, and said the fact that he probably owed taxes from his use of the car service had first occurred to him "earlier in the year."

Daschle's problems were not confined to failure to report income from lavish perks. In his amended returns, Daschle included \$83,333 in previously unreported consulting income and lowered three years of charitable contribution deductions by a total of \$14,963.

Those were aggressive positions comparable to Treasury Secretary Timothy Geithner's repeated failure to pay self-employment tax and his attempt to deduct his children's camp costs as child-care expenses. In December, Geithner had to pay about \$34,000 in back taxes when the transition team discovered that he had not paid self-employment payroll taxes while working at the International Monetary Fund. (For prior coverage, see *Tax Notes*, Feb. 2, 2009, p. 590, *Doc 2009-1677*, or *2009 TNT 15-1*.)

Errors? Unintentional? A taxpayer who has been repeatedly apprised of the need to report a particular item could be negligent. "Based upon the *Drew* decision, Mr. Geithner went way beyond innocent error to at least negligence," said Steven Bankler, a San Antonio CPA and tax return preparer.

Drew v. Commissioner, T.C. Memo. 1972-40, is only a memorandum decision, but that's how obvious the law on this question is. The taxpayer, a closely held corporation, continued to deduct cash payments to public officials to obtain business for three years, despite being told that the payments were nondeductible in its audit for a previous tax year. The Tax Court upheld a section 6653 penalty for negligence or intentional disregard of the regulations for the first year after the audit. (In the penalty reform of 1988, the standard for negligence was changed to willful.)

How many times does a return preparer have to ask a client who is a public figure whether he was given anything of value?

Should a preparer have signed Geithner's and Daschle's returns? Here's the section 6694 question: How many times does a return preparer have to ask a client who is a public figure whether he was given anything of value?

Reg. section 1.6694-1(e)(1) states that a signing preparer can rely on information furnished by the taxpayer without verification, but "must make reasonable inquiries if the information as furnished appears to be incorrect or incomplete." Moreover, "the tax return preparer must make appropriate inquiries to determine the existence of facts and circumstances required by a Code section or regulation as a condition of the claiming of a deduction or credit." (For the new final section 6694 regulations, see *Doc 2008-26370* or *2008 TNT 242-11*.)

Nomenklatura

The Obama administration promised to reduce the influence of lobbyists on policymaking and has prohibited lobbyists from holding appointed offices. Except, apparently, Daschle.

Daschle, who hired himself out as a strategic adviser, never registered as a lobbyist. "Mr. Daschle has operated in the gap between the popular understanding and the legal definition of a lobbyist," *The New York Times* delicately put it. It's a distinction without a difference. He was cashing in on his experience and connections, hiring his services to the very hospitals and health insurers whose reimbursements he would be required to cut as health and human services secretary.

The last time we wrote about a public official abusing transportation privileges, it was White House Chief of Staff John Sununu, who had been under the apparent impression that his personal security entitled him to tax-free use of a car and driver. We used the word *nomenklatura*. (*Tax Notes*, Feb. 15, 1993, p. 829.)

Washington has a permanent class of *nomenklatura* with whom Obama must deal. Daschle was going to be the guy who took the president's health policy proposals to a reluctant Congress in the thrall of the well-funded beneficiaries of the current system. Daschle ruined his chances by acting like *nomenklatura*.

The Daschle episode also shows how Washington got a nomenklatura. No one ever goes home.

The New York Times, which called for Daschle to withdraw, explained that the episode illustrates how Washington works, in the sense of cashing in on experience and connections. (*The New York Times*, Feb. 2, 2009, p. A1, and Feb. 3, 2009, p. A26.) But it also shows how Washington got a *nomenklatura*. No one ever goes home. Former elected and appointed officials stay, and ersatz French restaurants that seem to be using a common vat of badly cooked white sauce stay in business.

Here's another reason Daschle should pay his taxes: He's from South Dakota. He and his fellow senators from states with no water and more livestock than people have spent their careers redirecting tax money from New York, New Jersey, Illinois, and Connecticut toward their states in the form of farm subsidies and other federal spending programs. Now that he's rich, Daschle should pay taxes like New Yorkers do, and see how it feels to be footing the bill for everyone else.

Limo

After meeting with the Finance Committee, Daschle, joined by several Democrats offering him their endorsement, told reporters that he had initially "failed to realize" that the car "was income and not a gift from a good friend."

"Car and driver" is an East Coast euphemism for what people in the business call a limo, even when the vehicle isn't stretched, white, or used on prom nights. Car and driver sounds more democratic, small "d." Yet Senate Finance Committee member and former tax administrator Kent Conrad, D-N.D., was somehow able to characterize Daschle's chauffeured Cadillac as a "loan" of a car that most people would not consider income. He wasn't in either of the Dakotas when he said that.

Daschle owed a lot of tax on his car and driver. It was only after being nominated for the health and human services job that Daschle estimated that he had used the car service 80 percent of the time for personal trips and 20 percent for business, yielding a total of \$255,256 in unreported income over three years. Even after he corrected his tax returns, Daschle made the further admission that he had failed to pay roughly \$6,000 of self-employment tax on this perquisite.

The value of this perquisite indicates that the car and driver were either on 24-hour call or perpetually double-parked outside wherever Daschle happened to be at the time. The total cost would seem to be enough to cover a full-time driver and vehicle

upkeep, and Daschle's heavy personal use would indicate that service was always available. (Readers with unemployed adult children might want to consider a chauffeur's license.)

As an independent consultant to private equity fund management company InterMedia Advisors LLP, Daschle was provided with the car and driver by Leo Hindrey, the managing partner and a personal friend. Daschle chaired an advisory board for the fund management company, in addition to being a limited partner in the InterMedia Partners fund. It is not clear what advice he gave, but Hindrey at one point wanted to chair the Democratic National Committee. Hindrey has also been mentioned as a potential secretary of commerce or U.S. trade representative.

InterMedia paid Daschle \$1 million annually in consulting fees for this advice, which does not reflect well on an administration that has promised financial reform. Daschle failed to report more than \$80,000 of those consulting fees when the firm failed to provide a Form 1099 for one month.

"His 'excuse' is that he didn't get a 1099!" Bankler reacted, noting that Daschle had been a Finance Committee member. "Between Geithner and Daschle, maybe the IRS should consider revising the profile of the taxpayers that are the cause of the tax gap. Currently, they believe that a substantial portion of the tax gap involves self-employed taxpayers who deal in cash."

Health Policy

Daschle does know something about health policy. But he was not the only person capable of doing that job. And he could be viewed as compromised beyond his tax problems, as *The New York Times* hinted. One of his biggest lobbying clients, UnitedHealth, is a major provider of Medicare supplement policies. (*The New York Times*, Feb. 2, 2009, p. A1, and Feb. 3, 2009, p. A26.) *The Washington Post* suggested the withdrawal may also have been attributable to conflicts of interest. (*The Washington Post*, Feb. 3, 2008.)

If the Obama administration were serious about universal care, it would not put anyone who had ever taken a dime from a private health insurer in charge of health policy. Private insurers are the market participants most likely to see their profits cut in any sensible reform. Other countries keep costs down by having a single payer; only the rich use private insurance.

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Health and human services secretary is not an inconsequential position. Medical care is 17 percent of GDP. The government is the purchaser of one-third of it. Daschle would have been in charge of all that. He also was tapped to lead a new White House Office of Health Reform. He would have worked with the Finance Committee, which oversees many aspects of health policy, from Medicare and Medicaid to the tax treatment of medical insurance.

Medicare costs \$469 billion annually, and Medicaid costs the federal government \$221 billion annually (states pay part of the cost). Medicare, Medicaid, and Social Security (roughly \$600 billion annually) comprise three-quarters of mandatory spending. The United States government is, as economist Paul Krugman so aptly put it, “a pension plan with an army.”

The United States chose the wrong path in World War II — after which nearly every other western democracy went to a single-payer system — and is now stuck with it. The United States is stuck with delivery of health insurance through employment, which, while it costs employers a bundle, has the effect of keeping workers frightened of losing their jobs.

The fancy social science phrase for being permanently stuck on the wrong path is “path dependent.” It means patching the current system — or, in the case of American health policy, systems — instead of a sea change to a big new system. (*The New Yorker*, Jan. 26, 2009, p. 26.)

The United States spends \$246 billion per year subsidizing medical insurance delivered through employment, slightly more than the federal share of Medicaid, making it the largest tax expenditure. (If the tax expenditure were considered a government purchase, then the government would be the purchaser of 57 percent of medical care.) It will continue in this pattern, putting on patches to fill the growing gaps.

The COBRA assistance in the stimulus bill is a big step in patching, in the form of financial aid for individuals buying into a former employer’s plan. Policymakers are beginning to see that there is no reason the existing government programs — mostly they think of the buy-in for federal employees — cannot be extended.

Policymakers are discussing the Massachusetts plan. The state plan requires people to buy their own insurance from private insurers, subsidizes some purchases, and caps premiums as a percentage of income. Individuals who fail to purchase insurance and employers that fail to provide it have to pay a tax penalty. One year after the plan was adopted, 97 percent of state residents had insurance.

The government may pay for insurance and set the policy terms, but the currently uninsured will have to go through the motions of buying private policies. Yes, it’s ridiculous to have the extra step of individual purchases of policies and the extra cost of keeping private health insurers in business, but that’s the price of path dependency.

First 100 Days

Candidate Obama proposed piecemeal change. Obama promised tax credits to assist individuals and small employers with insurance premiums. He promised to expand Medicaid eligibility and require children to have insurance coverage. He would require large employers that do not provide insurance to contribute to a national plan. He is very interested in improving recordkeeping and quality of care.

Even those limited goals will be difficult to achieve with a paralyzed legislative process. Daschle was perceived as having lost credibility with Senate Republicans, who grouched that a Bush nominee with the same tax problems would have been toast.

Oh, but Obama is an intelligent and charismatic guy, and he’ll get beyond this. This argument ignores several facts of life. Obama is not at the beginning of his crucial first 100 days in office. He’s near the end. How is that?

There is only one president at a time, as Obama noted. Here’s the timeline. When the financial meltdown got really bad last September, Treasury Secretary Henry Paulson assumed the presidency. George Bush became press secretary and was trotted out to periodically reassure the populace that the world was not coming to an end. When he gave his first major economic speech shortly after being elected, Obama became the president. By this calculation, he hasn’t got much time left in his first 100 days.

So the loss of credibility from the Daschle appointment, as *The New York Times* suggested, may have prevented anything worthwhile from being accomplished in health policy at a time when the number of uninsured is on the increase. ■